Concept Paper

SNIE: IMPLICATIONS OF MEXICO'S CURRENT FINANCIAL CRISIS

This estimate will examine Mexico's present financial crisis and its political and economic implications both for Mexico and the United States through the first six months of the De la Madrid Administration. It will assess the various measures that the government has taken and those political and economic options that remain open to it. Finally, it will describe the most probable short-term outcomes and suggest a set of indicators to give early warning of a worse-than-expected outcome. It will not address the implications of the crisis for the stability of the international financial system.

Mexico's enviable record of economic growth and political stability is the result of the country's highly authoritarian political system -- what has been described as a "serial dictatorship." The elites as well as the Mexican masses have generally supported the system -- despite an awareness of its faults -- on the basis that it has worked for over half a century in an area of the world where even a decade of growth and stability is unusual. The current financial crisis, which is unprecedented in recent Mexican history, may indicate to many Mexicans that the system has broken down. The politically important middle class is already suffering the effects of inflation and the decline of the peso on its savings and standard of living. Austerity measures, including the reduction of subsidies for food and fuel and a deliberate slowdown in the creation of new jobs, will soon hit the lower classes. Erosion in support for the system, once started, could advance rapidly. The final result could be a series of weak governments or a far more oppressive dictatorship of the right or the left.

Even if the system is able to survive -- and we believe that the odds favor such an outcome -- the implications for US interests are many. Continuing large devaluations of the peso are radically changing the US-Mexican wage differential, thus greatly increasing the attractiveness of the United States for illegal migrants. At the same time such devaluations undermine the economies of US border cities dependent upon Mexican trade. Of equal or greater importance, the large value of US loans to the Mexican government and to private firms could threaten the solvency of individual US banks and have repercussions throughout the financial system. Finally, the prospect of a lessening of political stability on our southern border cannot fail to be of concern to the US government.

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